Mexico's 2018 Growth Outlook Revised Down Slightly

October 4, 2018

Mexico’s consensus growth forecast for 2018 worsened slightly from 2.3 percent in July to 2.1 percent in August. The 2019 forecast held steady at 2.2 percent. In addition, second-quarter gross domestic product (GDP) growth was revised down further from -0.4 percent to -0.6 percent (quarter/quarter). A drop-off in public and private investment in the second quarter contributed to the weak output growth.

More recent data are mostly positive. Mexico’s monthly GDP proxy measure increased in July, as did industrial production and retail sales, and formal employment continued to expand in August at an above-average pace. On the other hand, exports were flat in July and inflation increased for the fourth month in a row. The peso strengthened some against the dollar in August.

**Monthly Economic Activity Index Up in July**

Mexico’s global economic activity index, the monthly proxy for GDP, grew 0.4 percent in July after falling 0.1 percent in June. On a year-over-year basis, the activity index jumped 2.8 percent (Chart 1). Service-related activities (including trade and transportation) increased 0.3 percent in July over June. Goods-producing industries (including manufacturing, construction and utilities) ticked up 0.2 percent, and agricultural output grew 2.6 percent.

**Exports Flat in July but Up Year to Date**

Total exports were flat in July after falling 1.3 percent in June. Oil exports declined 3.2 percent, while manufactured-goods exports ticked up 0.2 percent. As a result, three-month moving averages of oil, manufacturing and total exports have fallen for three months in a row (Chart 2). Detailed data on export destinations suggest the recent slowing is in non-U.S. exports. Nevertheless, total exports year to date are up 8.1 percent, with manufacturing exports up 6.2 percent and oil exports up 38 percent, compared with the same period last year. The rise in oil exports in 2017 and early 2018 stems largely from higher oil prices, not an increase in the volume of exports.

**Industrial Production Up in July**

Mexico’s industrial production (IP) index, which includes manufacturing, construction, oil and gas extraction, and utilities, grew 0.2 percent in July after a 0.4 percent increase in June. The manufacturing index was flat in July after growing 0.3 percent in June. Three-month moving averages ticked up for both manufacturing and total production (Chart 3). Meanwhile, north of the border, U.S. IP rose 0.4 percent in August after growing 0.4 percent in July. The correlation between Mexico’s IP and the U.S.’ IP has increased considerably due to increased intra-industry trade since the implementation of the North American Free Trade Agreement.
Retail Sales Grow in July

Retail sales grew 0.6 percent in July after posting no change in June. The three-month moving average shows a sharp turnaround from the depressed levels observed during the second half of 2017 (Chart 4). Retail sales are up 4.2 percent year over year in July. Sales were suppressed in 2017 by high inflation (which pushed prices higher relative to wages), elevated interest rates (which raised the cost of credit) and depressed consumer confidence.

Job Growth Continues

Formal sector employment—jobs with government benefits and pensions—grew an annualized 3.3 percent in August but was slower than July’s 5.8 percent (Chart 5). Year-over-year job growth was 4.0 percent in August. The unemployment rate in July was 3.4 percent, about the same as a year ago.

Peso Gains Some Ground in August

The Mexican currency averaged 18.9 pesos per dollar in August, a 0.8 percent appreciation from July (Chart 6). Since December, the peso has inched up 1.7 percent against the U.S. dollar; however, it is still below year-ago levels. The Mexican currency has been under pressure as a result of increased uncertainty regarding U.S. trade policy. In addition, the U.S. dollar has strengthened because of faster growth, higher interest rates and emerging-market turmoil.

Foreign-Owned Government Debt Share Holds Steady

The share of peso-denominated Mexican government debt held abroad was steady in August at 31.9 percent. Beginning in February 2017, the share has fallen, although the decline has slowed in recent months (Chart 7). The extent of nonresident holdings of government debt is an indicator of Mexico’s exposure to international investors, whose holdings could quickly reverse if they perceive a change in market sentiment.

Inflation Edges Up

The consumer price index (CPI) increased 4.9 percent over the prior 12 months in August, up slightly from 4.8 percent in July (Chart 8). Inflation was moving closer to Banco de México’s target of 3 percent earlier this year but changed course in June. CPI core inflation (excluding food and energy) rose 3.6 percent over the 12 months ending in August. Mexico’s central bank raised its benchmark interest rate by 25 basis points to 7.75 percent on June 21 but held policy rates steady at its August meeting. Higher U.S. interest rates and global trade tensions have increased the peso’s volatility, posing a risk to inflation and leading to tighter monetary policy.

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